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Baker And Miyazawa -- Round Two

In their January 21 meeting in Washington, Treasury Secretary James Baker and Finance Minister Kiichi Miyazawa reaffirmed their October 31 agreement to cooperate on exchange market issues (see JEI Report No. 41B, November 7, 1986). In a four-paragraph statement issued after the meeting, the two

developed countries that followed sound domestic policies, he suggested. The resulting economic growth would obviously benefit the debtor nations but would also provide the United States with more lucrative export markets. On the domestic side, he maintained that the government should take steps to shrink the gap between domestic savings and investment and improve lagging productivity by stimulating education, research and development, and the availability of capital.

According to Mr. Greenspan, the ideal solution to the U.S. trade deficit would be a "continued gradual reduction in the exchange rate of the dollar" to enable U.S. producers to improve their competitive position. As for trade legislation, he stressed that Congress should focus on facilitating the adjustment of domestic industries by improving training programs and resource mobility.

Mr. Dornbusch suggested that a confluence of international economic factors has made a decline in our standard of living inevitable. He said that the best policy option would be to minimize and hasten the decline by implementing exchange rate, interest rate and federal budget adjustments. He also concentrated on the significance of the LDC debt crisis, which he said has slashed U.S. exports of manufactured products to developing countries by more than $40 billion since 1980. Consequently, he favored addressing the issues of third world debt by providing debt relief similar to that proposed by Sen. Bill Bradley (D, N.J.).

With regard to U.S. trade law, committee members seemed anxious to devise a system that would require some sort of relief for injured industries but would be flexible enough to allow the president to pursue other economic and strategic goals. All agreed, however, that while such a balance is highly desirable, it will be difficult to legislate. Moreover, there were questions about dealing with the problem of reciprocity. Mr. Hormats discouraged a sectoral "eye-for-an-eye" approach, suggesting a flexible law that would allow for market access trade-offs between sectors -- a result that could substantially benefit the United States.

All in all, the first set of Senate trade hearings was extremely general, and purposely so. Committee members spent most of their time gauging the opinions of witnesses and collecting ideas about legislative solutions. Perhaps the most commonly asked question was, "How do you suggest we do that?" The senators seemed to be testing as many ideas as possible before hearing administration testimony. Discussions with executive branch officials will begin February 19 in the Finance Committee and February 10 in the House Ways and Means Committee, following some early February hearings with private-sector representatives.

Eileen Marie Doherty

Tokyo Makes It Official: Car Limits To Continue

Protectionist pressures have institutionalized restraints on Japan's U.S.-bound car shipments. International Trade and Industry Minister Hajime Tamura acknowledged as much in announcing January 27 that exports of cars to this country would remain capped at 2.3 million units through March 1988. But the decision to limit shipments for a seventh year won Tokyo few political

points, whether on Capitol Hill or in Detroit, because it did not offer a quick fix for the bulging bilateral trade deficit, roughly half of which is attributable to U.S. imports of Japanese-made cars, trucks and automotive parts. Continued restraints "will not influence the course of trade legislation in Congress nor provide significant help to U.S. automakers and their employees," said Sen. John Danforth (R, Mo.) echoing the sentiments of other congressional supporters of increased protection for American automotive producers.

Ford Motor Co., Chrysler Corp. and the United Auto Workers union also gave Tokyo's announcement short shrift. Taking another year of restraints as a given, they had recently stepped up their campaign for a rollback in the export ceiling, which has been set at 2.3 million units a year since April 1985 (see JEI Report No. 2B, January 16, 1987). This option was apparently considered by the Japanese government. Proponents argued that it might rob the protectionist movement of some of its momentum while not costing exporters any sales. Like virtually every American automotive industry analyst, they reasoned that the combination of softer U.S. car demand, expanded competition from other offshore suppliers, high sticker prices for Japanese nameplates and the fast-increasing output of U.S.-assembled Japanese models ruled out any chance that the American import units of Japan's motor vehicle makers could repeat their 1986 sales results.

These arguments did not sway MITI. Rejecting the conventional wisdom in this country, Mr. Tamura said the ministry believed exporters would ship more than 2.3 million cars to the United States over the April 1987-March 1988 period in the absence of any restraints. Therefore, by maintaining the shipment cap at its FY 1985-FY 1986 level, Tokyo was in effect cutting exports.

Having extended the export restraints for yet another year, MITI must now decide how many cars individual manufacturers can ship to the United

Unofficial Quota Allocations, FY 1981-FY 1986

(in units)

Exporter	FY 1981-FY 1983 Quota	FY 1984 Quota	FY 1985-FY 1986 Quota
Toyota Motor Corp.	516,659	551,792	620,800
Nissan Motor Co., Ltd.	456,030	487,040	547,900
Honda Motor Co., Ltd.	348,631	372,338	428,600
Mazda Motor Corp.	159,282	173,468	229,700
Mitsubishi Motors Corp. (including sales to Chrysler Corp.)	112,584	122,612	186,200
Fuji Heavy Industries, Ltd.	70,014	76,250	117,200
Isuzu Motors, Ltd. (including sales to General Motors Corp.)	16,800	49,500	117,100
Suzuki Motor Co., Ltd. (for sale to General Motors Corp.)	0	17,000	52,500
Total*	1,680,000	1,850,000	2,300,000

States. Unofficial sources in Japan say this will not be the pro forma decision it was in 1986. Daihatsu Motor Co., Ltd., the only car manufacturer that does not have a quota allotment, wants to begin U.S. sales this year, while Japan's other small exporters still feel shortchanged by MITI's allocation system. Obviously, the only way the ministry can accommodate second-tier makers is to cut the quotas of the top exporters -- Toyota Motor Corp., Nissan Motor Co., Ltd. and Honda Motor Co., Ltd. On paper Honda is the most likely candidate because it has the largest U.S. production capacity, but whether the number-three import seller is willing to be penalized for having pioneered onshore assembly is another question.

Susan MacKnight

Spring Wage Offensive Has Weak Start

The strong yen has severely weakened the position of Japanese labor unions at the outset of the nation's annual wage negotiations. Every major industry has reported a sharp drop in profits and forecasts slow business conditions this year. In addition, union members are extremely concerned about job security because of manufacturers' plans to expand overseas production. On top of all this, the government is encouraging firms to offer customary wage hikes to help pump up domestic spending. Labor and business leaders will have a difficult time satisfying these conflicting demands.

The 60 percent appreciation of the yen over the past 16 months has put strong pressure on the normal operating profits of every export industry, especially motor vehicles and electronics. Most Japanese firms have been able to prevent profits from disappearing completely by accepting paper-thin margins and instituting cost-cutting measures. Shipbuilding and steelmaking, two industries that have traditionally set the pace for wage settlements, have experienced particularly dismal business conditions.

Since these firms represent the core of the Japanese economy, it is not surprising that the shockwaves have been widespread. While big companies may be able to weather the storm, small businesses have less room to adapt. Subcontractors have been forced to accept price cuts, and low-technology export industries, such as ceramics and cutlery, have been very hard-hit. According to Tokyo Shoko Research Co., Ltd., as many as 623 of the 17,476 bankruptcies in 1986 could be attributed to the impact of the stronger yen -- almost 50 percent higher than the number recorded in the yen surge of 1978.

Poor business conditions have also contributed to the gradual increase in unemployment. Although structural factors, including more part-time and female workers, were increasing the workforce at the same time that increased automation of production and slower overall economic growth were reducing the growth in job openings, it was the strong yen that pushed the unemployment rate up to a postwar record of 2.9 percent last August. Tokyo predicts that the jobless rate will hit 2.9 percent for fiscal 1986, up sharply from FY 1985's 2.6 percent level.

The Japan Federation of Employers' Associations (Nikkeiren) has warned workers not to expect any wage increases this year. Each company must be treated differently according to its financial health, with particular weight

given to the influence of the yen. Nikkeiren warned, however, that even in areas of strong growth, such as service industries, wage increases may blunt Japan's international competitiveness.

Despite all these problems, some labor leaders have called for wage hikes equal to those won last year, an average 4.5 percent (see JEI Report No. 17B, May 2, 1986). This increase, they claim, combined with the government's proposed tax reform program would give domestic demand a major boost, offsetting some of the drag from weaker exports. This position is backed by the government, but even this is unlikely to sway employers.

Union cohesion, an important weapon in wage talks, is fragmenting. The steel, shipbuilding and coal mining unions, the traditional pacesetters in wage negotiations, have shelved any hopes of wage increases as management strives to restore financial health. Instead they have focused on job security. Unions associated with the Japanese National Railways, also traditional pacesetters, have been wracked by the government's plans to privatize and rationalize the giant rail system, neutralizing any impact they may have had on nationwide wage talks. Even workers in the industrial and consumer electronics industries, where the highest wage increases have been granted in the past several years, are under heavy pressure from management.

The fact that the increase in the average winter bonus for 1986 dropped to an 11-year low is probably a harbinger of things to come. Employees received an average bonus of Y582,103 ($3,755 at Y155=$1.00), just 0.83 percent above 1985, according to a Nihon Kezai Shimbun survey. Manufacturing was hit across the board, while the service industries -- and particularly securities firms -- showed some gains (see Table).

While this year's wage hike is at the top of the unions' agendas, it is not the only problem. The strong yen is forcing fundamental changes in the Japanese economy. First, there is more emphasis on service industries. White-collar fields and low-tech service industries, in particular, are not areas of union strength. Of even greater concern is the growth of foreign direct investment and the increasing use of foreign subcontractors. According to the Ministry of International Trade and Industry, investment in foreign manufacturing facilities will grow at an annual rate of 14 percent in dollar terms through the end of this century, translating into a loss of 700,000-800,000 jobs. The Economic Planning Agency estimates that Japanese foreign direct investment will create 1.2 million jobs abroad and reduce the number of domestic positions by about half that number by the year 2000. Estimates by private research firms are less dire but still predict job losses in the range of 500,000. Even the most optimistic of these forecasts would push unemployment up to 4 percent, forcing union leaders and government officials to begin planning now.

The current pressures are already changing labor-management relations by eroding Japan's much-vaunted lifetime employment system. The massive layoffs planned in mining, shipbuilding, steel and other heavy manufacturing industries will test the famed cooperative spirit, since many of those laid off cannot be retrained for high technology or service jobs. Although big companies are encouraging older workers to retire early and are shifting workers to subsidiaries and related firms, such measures are limited and temporary. It is not

clear how companies and unions will meet this challenge. Some predict the end of peaceful relations, while others feel that the system will survive in a modified form. If the yen continues to rise, however, all bets are off.

Jon Choy

Initial Survey of Winter Bonuses, 1986

(pre-tax, weighted average bonus in yen)

Industry	Number of firms	Bonus	Change
Energy	29	¥630,900	3.98%
Metals	61	507,687	-5.56
Chemicals	92	601,559	0.11
Textiles, paper and pulp	31	596,470	1.59
Food products	66	642,609	1.88
Electronics	118	544,495	-4.51
Electric and nonelectric machinery	149	564,785	-3.17
Motor vehicles	80	597,638	0.84
Shipbuilding and defense	20	469,724	-7.99
Transportation and warehousing	49	634,991	4.80
Construction, housing and real estate	101	608,882	0.89
Services, leisure and fashion	39	588,922	2.38
Information	48	764,722	1.06
Trading companies	10	707,719	2.86
Retail companies	39	558,682	4.30
Securities companies	7	835,293	13.52
All industries	939	582,103	0.83
Settled as of November 26	804	579,838	0.65

Source: Nihon Keizai Shimbun

Big Profits For Securities Firms

Amidst the complaints about the adverse impact of the strong yen by Japan's export-oriented firms, Japanese securities traders are trumpeting a year of record profits. Financial liberalization, ample amounts of under-utilized funds, exchange-rate fluctuations and the heightened interest of Japanese investors in foreign investments have all worked to the advantage of the financial middlemen.

Tokyo's financial liberalization program has opened new markets for securities dealers, particularly the Euroyen market and the bond futures market. The market for Euroyen bonds now rivals that of bonds denominated in Deutsche marks. The total amount floated in 1986 was somewhere in the neighborhood of $12 to $16 billion, far ahead of 1985's $6.5 billion total. The bond futures market, which opened in October 1985, was the biggest in the world

in terms of volume in 1986, trading contracts worth Y1,870 trillion ($12.1 trillion at Y155=$1.00). In addition, 1986's two-way trade in bonds probably totaled over $2 trillion, easily outdistancing 1985's $13 billion level.

Financial liberalization has also injected vitality into existing domestic markets. Although securities companies faced greater competition for investor funds from banks, which offered several new instruments, there was plenty to go around. Corporations and individuals flush with cash became much more daring in their financial planning -- zaitech or "financial technology" was the buzzword -- and securities companies naturally benefited. The Tokyo Stock Exchange boomed, adding strength to the fundamental securities business. The Nikkei average started last year at around 13,000 and rose to almost 19,000 by year's end. The index reached a record 19,554.72 on January 26 and market watchers predict that the 20,000 barrier will be broken this year.

Foreign markets and foreign investments are taking on greater importance as Japan integrates its economy in global financial markets. The yen's appreciation and large cash reserves have made major Japanese institutions instant stars on international markets. In addition to the Euromarket, securities firms have increased their presence in the United States. In fact, their expansion has been so rapid that it has generated some backlash among American financial institutions.

All this activity added up to record profits (see Table). At the end of their fiscal year (September), unconsolidated pre-tax profits of the Big Four brokerage houses (Daiwa Securities Co., Ltd., Nikko Securities Co., Ltd., Nomura Securities Co., Ltd. and Yamaichi Securities Co., Ltd.) reached Y986.6 billion ($6.4 billion). The Big Four's overseas subsidiaries have just reported pre-tax profits totaling Y83.3 billion ($537.4 million) for the same period, 2.3 times their 1985 showing.

Pre-Tax Profits of Japan's Major Securities Firms, FY 1986

(year ending September in billions of yen)

	Parent Company			Foreign Subsidiaries		
	FY 1985	FY 1986	Change	Number	FY 1986 Profits	Change
Nomura Securities Co., Ltd.	Y210.2	Y389.5	85.3%	10	Y38.2	110%
Daiwa Securities Co., Ltd.	122.9	232.5	89.2	7	20.8	170
Nikko Securities Co., Ltd.	112.5	195.8	74.1	8	12.5	130
Yamaichi Securities Co., Ltd.	103.5	168.8	63.2	11	11.8	150

Source: Nihon Keizai Shimbun

Nomura, the biggest of the group, reported that its London affiliate, Nomura International Ltd., saw earnings jump 170 percent to Y12 billion ($77.4 million). Nomura Securities International Inc., based in New York, raked in Y4.5 billion ($29 million) in pre-tax profits, a gain of 90 percent. And Nomura International (Hong Kong) Ltd. reported an 80 percent increase in profits to Y9.1 billion ($58.7 million). Not surprisingly, the overseas offices of the Big Four reported a 50 percent gain in employment to handle the surge in business. It is clear that international markets are becoming more important to Japanese financial institutions and vice versa.

Jon Choy

Agricultural Reform In The Offing?

Despite the outcry precipitated in Japan by the Rice Miller Association's attempt to force the country to overhaul its rice program (see JEI Report No. 33B, September 12, 1986), there appears to be increasing debate over the need to reform the agricultural sector and adjust government policies accordingly. Several arguments have been offered in favor of reform. First is the simple matter of costs. With the successful conclusion of the cabinet's administrative reform drive, agriculture is one of the few areas in which the government may be able to reduce financial burdens in the name of economic efficiency. With the ruling Liberal Democratic Party apparently gaining voting strength in urban areas, reform proponents argue that gradually reducing payments to farmers and easing import restrictions would moderate food costs for urban constituents while allowing sufficient time for farm interests to adjust. It would also reduce the government's huge outlays and conform to the Ministry of Finance's long-term fiscal reconstruction plans.

Agricultural reform clearly is the most explosive political issue in Japan. Despite the LDP's new strength, the party still relies on rural voters for support and must be careful not to alienate them. Even opposition parties have made appeals to rural voters by proposing "food security" planks in their political platforms. Nevertheless, the reform debate has continued, spurred in some respects by the rice millers' petition. Some press reports have alluded to proposals to increase dramatically quotas on such contentious products as beef and citrus. While many of these reports may be premature, their regularity suggests that a long consensus-building process concerning agricultural imports may be under way.

Should policymakers opt for significant reforms, however, the process would be gradual. Quota increases, for example, most likely would be negotiated within a multilateral context rather than with specific trading partners. Any reductions in government subsidies or import liberalization moves would be phased in over several years to minimize disruptions to the agricultural sector. In short, it is unlikely that a foreign government would have much to gain by making the issue a political hot potato since no one administration is likely to remain in office long enough to take credit for any changes. Nevertheless, from a long-term economic and political perspective, the rumblings at the moment may be the beginning of a transformation as significant to Japan as any of the government reforms of the previous half decade.

Michael W. Chinworth

NOTE

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